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Housing Finance Reform Gains Unexpected Momentum in Congress

By John J. McKechnie

While Congress appears to be stalemated on issues such as Obamacare repeal and replacement, tax reform and rollback of Dodd-Frank, housing finance reform is emerging as a surprise issue that may become law later this year.

This pronouncement comes from senior Senate aides and Senate Banking Committee Chairman Mike Crapo, (R-ID), who has begun to outline his plans to reform Fannie Mae and Freddie Mac and overhaul the federal footprint in the mortgage market.

At a May Senate Banking hearing on the housing finance system, Crapo, called reform “a key priority” for the current Congress and urged his colleagues to begin “a deliberate and careful process” to collect ideas and draft legislation “that would address the unsustainable Fannie and Freddie conservatorships.”

CONCERN OVER GSE REVENUES

Crapo and other Senators on both sides of the aisle raised concerns

that, while Fannie and Freddie are currently earning profits, if the housing market experiences a downturn, GSE revenues could suffer a hit and taxpayers could again be on the hook for billions of dollars.

Testifying before the Committee, FHFA Director Mel Watt sounded a similar tone about the need for action. Watt said that “neither GSE will have the ability to weather any loss it experiences in any quarter without drawing further on taxpayer



support. This is not a theoretical concern. ...” He pointed to Jan. 1, 2018, as the date when both Fannie and Freddie capital would be depleted.

Watt also stated that he is reviewing the current arrangement between Fannie, Freddie and the Treasury in which the GSEs remit their quarterly profits. Allowing them to keep their profits, according to Watt, would stabilize Fannie and Freddie and could prevent another liquidity crisis in the mortgage market that would stem



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from undercapitalized GSEs.

The suggestion that Watt may halt those payments and allow Fannie and Freddie to retain some or all of their earnings in order to build a capital buffer drew a sharp rebuke from Chairman Crapo. “I strongly urge you not to undo the repayments to the taxpayer,” Crapo said. “Congress would surely react to any such unilateral action on your part.”

CSP MAY PROVIDE NEW STARTING POINT

According to Senate Banking staff, bipartisan discussions are underway that utilize the Common Securitization Platform (CSP) as a starting point for any new housing finance system.

The platform, initiated by FHFA under former Acting Director Ed DeMarco, was originally intended to function like a market utility that would be used to issue both agency securities

and private label securities. The platform has instead been developed specifically for securities issued by Fannie Mae and Freddie Mac.

Senators are reportedly exploring legislation that would expand the Ginnie Mae platform to act as an alternative method of providing a federally guaranteed source of market liquidity.

Another element of a new housing finance system under consideration is the increased transfer of credit risk

from the GSEs to the private sector.

One component of housing reform legislation may mandate different forms of risk transfer, including both front-end and back-end structures. This would have the intended effect of bringing more private capital into the market, in place of the role currently filled by Fannie and Freddie.



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WHAT DOES THE FUTURE LOOK LIKE?

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Republicans and Democrats, even in the early stages of discussing a bill, appear divided on whether Fannie and Freddie would be restructured and brought out of conservatorship, or would be merged into a new utility-like entity that securitizes and provides mortgage market liquidity.

Timing for housing reform legislation is another unresolved issue, but if Watt and other market watchers are correct, an unreformed GSE system could trigger another crisis next year.

Will Congress wait until the crisis before acting? History says “probably,” although the Senate discussions, even if preliminary, provide some hope for a proactive solution. ▲

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